

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Hollingsworth Analyst: Darrine Distefano Bill Number: SB 4
Related Bills: See Legislative History Telephone: 845-6458 Amended Date: May 1, 2003
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Exclusion/Interest Received By Widow Or Child Of Person Who Died In Combat While On Active Duty

SUMMARY

This bill would exclude from gross income interest payments on government insurance proceeds received by a widow or child from an individual who died in combat while on active duty.

This bill is a restatement of existing law.

SUMMARY OF AMENDMENTS

The May 1, 2003, amendments delete language that would have phased-out the personal income tax rates and the alternative minimum tax over a five-year period and add the provisions discussed in this analysis.

The department's previous analyses of this bill no longer apply.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide tax relief to surviving family members that must pay tax on interest accrued due to a delay of insurance payments.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately and apply to taxable years beginning on or after January 1, 2003.

POSITION

Pending.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director
Gerald H. Goldberg

Date
6/4/2003

ANALYSIS

FEDERAL/STATE LAW

Under federal and state laws, compensation received by a member of the Armed Forces is subject to income tax unless specifically excluded. Compensation received for any month while serving in a combat zone or qualified hazardous duty area is excludable. Qualified military benefits that are excludable from income include:

- Any benefits paid by the Veterans Administration, such as disability compensation, pensions, educational assistance, insurance payments, etc.;
- Certain medical benefits, military disability benefits, and various travel allowances; and
- Dislocation allowances, temporary lodging allowances, and move-in housing allowances provided for a permanent change of station.

Existing federal law (Veteran's Benefits - Title 38, Part II, Chapter 19, Subchapter III, Section 1970) provides a Servicemembers' Group Life Insurance (SGLI) benefit to active duty members of the Armed Forces. Existing federal (Section 134 of the Internal Revenue Code (IRC) and Title 38, Section 5301) and state law (Section 17131 of the Revenue & Taxation Code) provides that any amounts received from the SGLI are excluded from gross income. These amounts include any delayed settlement interest or installment interest received in addition to insurance proceeds.

"Armed Forces of the United States" is defined under IRC Section 7701, and used for purposes of IRC Section 692, to include all regular and reserved components of the uniformed services that are subject to the jurisdiction of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force, and also includes the Coast Guard. Members also include commissioned officers, and personnel below the grade of commissioned officer in such forces.

"Combat zone" under IRC Section 112, and referred to in IRC Section 692, in pertinent part, means "any area which the President of the United States by Executive Order designates as an area in which Armed Forces of the United States are or have (after June 24, 1950) engaged in combat." In addition, such zones include qualified hazardous duty areas.

THIS BILL

This bill would exclude from gross income any amount of qualified interest received by a widow or any child of an individual who died in combat while on active duty with any branch of the Armed Forces of the United States.

This bill defines "qualified interest" as any interest accrued prior to any amounts paid under an insurance policy provided by the Armed Forces of the United States. If an SGLI payment is delayed, interest will accrue from the date of the insured's death to the date of settlement. Also, if an SGLI payment is made to a beneficiary in 36 equal installments, interest accrues on a portion of these installments. Interest in both situations is paid to the beneficiary with the SGLI payment. Both delayed settlement interest and installment interest would be considered "qualified interest" under this bill.

IMPLEMENTATION CONSIDERATIONS

As stated under *Federal/State Law*, any benefits received under any law administered by the Department of Veteran's Affairs (VA) are excluded from gross income. Since the VA administers the SGLI, the proceeds from the SGLI are exempt from taxation. If a beneficiary receives SGLI payments in 36 equal installments, the interest portion of these payments is exempt from taxation. Also, any delayed settlement interest resulting from the SGLI is exempt from tax. Since existing state law conforms to federal law, a surviving spouse or dependent who files a California tax return will not include any SGLI payments or interest in gross income. Consequently, this bill would not impact the department's programs and operations.

LEGISLATIVE HISTORY

SB 948 (Morrow, 2003/2004) would provide that all earned income of a spouse of a member of the Armed Forces who dies as a result of certain action be exempt from income taxes for the year of the member's death and the following three years. This bill is currently in the Senate Appropriations Committee.

AB 1073 (Dutton, 2003/2004) would exclude from gross income the death gratuity paid to a survivor of a member, former member, or person entering the service of, the Armed Forces of the United States. This bill is currently in the Assembly Revenue & Taxation Committee.

AB 294 (Zettel & Kehoe, 2001/2002) would have excluded from taxation all survivor benefits or payments received under several federal programs that provide benefits to survivors of deceased retirees of the armed forces. AB 294 failed to pass out of the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Massachusetts, Michigan, Minnesota, Illinois, New Jersey, and New York do not tax SGLI payments or any delayed settlement interest or installment interest.

Florida only has a corporation income tax; therefore, this personal income tax exclusion is not applicable.

ECONOMIC IMPACT

This bill would not impact the state's income tax revenue or the department's current programs or practices since the provisions are currently in practice.

LEGISLATIVE STAFF CONTACT

Darrine Distefano
Franchise Tax Board
845-6458
Darrine_Distefano@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
Brian.Putler@ftb.ca.gov